

## IDAHO FORECAST DESCRIPTION

### **The Forecast Period is the First Quarter of 2004 through the Fourth Quarter of 2007**

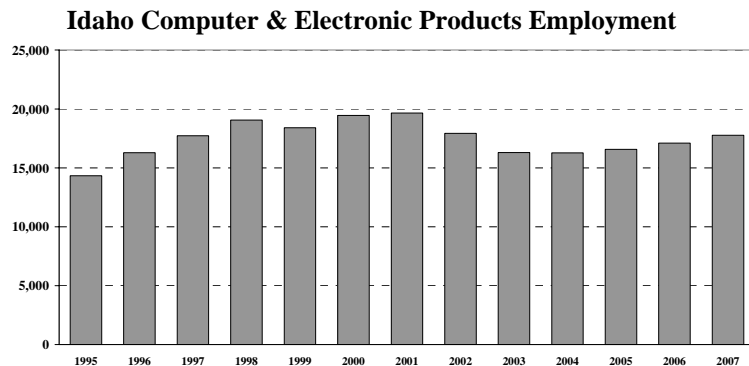
Last year was a transitional period for the Idaho economy. After stalling in 2002, the Gem state's economy began showing signs of recovery in 2003. The Idaho economy bottomed out in 2002. Two aggregate measures illustrate how challenged Idaho's economy was in 2002. In that year, there was a net gain of just two nonfarm jobs. Idaho real income eked out just 1.6% growth in that same year, which was its weakest showing in over a decade. Like its U.S. counterpart, the state took tentative steps toward recovery during the first half of 2003. Nonfarm employment showed promise early that year by increasing at a 1.8% annual rate in the first quarter. Unfortunately, this was followed by a 2.7% employment loss in the second quarter. However, this setback proved temporary. Idaho nonfarm employment advanced 1.0% in the third quarter of 2003 and 2.3% in the fourth quarter. This strong showing in the second half of the year made up for the losses suffered in the second quarter. There were approximately 700 more jobs at the end of the year than there were at its beginning. On an annual basis, Idaho nonfarm employment grew 0.8% in 2003.

Idaho personal income performance in 2002 and 2003 is complex compared to employment. Idaho nominal income advanced 3.8% in 2002, which was slightly higher than 2003's 3.5% growth. The stronger showing in 2002 resulted from a robust farm sector. For example, Idaho farm proprietors' income jumped 11.1% that year to just over \$700 million—its highest level since 1993. In comparison, farm proprietors' income shrank to \$657 million in 2003. Because the farm sector's contributions to income tend to be volatile, it is useful to look at personal income without farm income. A comparison of Idaho nonfarm income in 2002 and 2003 show both grew at about the same pace. Interestingly, on an inflation-adjusted basis, nonfarm income actually grew slightly faster in 2002 (2.2%) than in 2003 (1.8%).

The momentum displayed in the latter half of 2003 is expected to lift the economy to a higher and more solid footing over the forecast period. For example, Idaho nonfarm employment is expected to grow 1.6% in 2004. While this is slower growth than was experienced in the 1990s, it is twice as fast as the 2003's growth rate of 0.8%. Another feature of employment growth is it accelerates over time. Specifically, it advances 1.7% in 2005, 2.1% in 2006, and 2.2% in 2007. Looked at another way, Idaho is expected to enjoy a net job gain of nearly 45,000 from 2003 to 2007. Idaho real personal income expands 3.5% in 2004, 3.3% in 2005, 3.9% in 2006, and 3.5% in 2007.

It should also be pointed out that this job outlook is an improvement to the one reported in the previous *Idaho Economic Forecast*. In April 2004, it was projected Idaho nonfarm employment growth would average 1.8% annually. In the July 2004 *Forecast* it averages 1.9% per year. As a result, Idaho nonfarm employment is about 4,000 higher in 2007 compared to the previous forecast. There are several differences between the two forecasts that are worth noting. First, the improved construction employment outlook has augmented the outlook for the good-producing sector. The gains in construction employment more than offset the lowered expectations for manufacturing. Employment in most of the nongoods-producing sectors have improved. The most notable exception is federal government employment. The outlook for Idaho personal income has also improved. Compared to the previous forecast, Idaho real personal income is \$365 million higher in 2004, \$322 million higher in 2005, \$221 million higher in 2006, and \$97 million higher in 2007.

## SELECTED IDAHO ECONOMIC INDICATORS



**Computer and Electronics:** The return of real business investment suggests cautious optimism is in order for the state's computer and electronics sector. After shedding jobs in 2002 and 2003, Idaho's computer and electronics sector's payroll should begin expanding this year. Idaho computer and electronics employment peaked at nearly 20,700 in the first quarter of 2001 then shed nearly 4,700 jobs through the end of 2003. In 2001, Jabil Circuit,

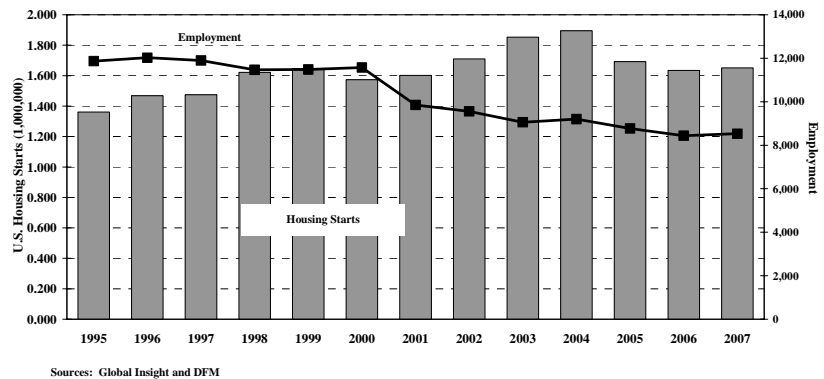
Micronpc.com, SCP Global Technologies, Micron MCMS, AMI, and Hewlett-Packard reduced their staffs. As a result, this sector's employment growth slowed from 5.7% in 2000 to 1.0% in 2001. The Gem State's computer and electronics sector suffered another round of layoffs in 2002, which caused employment to decline 8.8% in that year. Much of the blame for this decline can be attributed to the fallout from the bursting high-tech bubble. Fueled by the demands of the Telecommunications Act of 1996, concerns over Y2K, and the popularity of the Internet, real investment in computer equipment advanced by at least 40% each year from 1995 through 1999. The output of U.S. computer and electronic equipment averaged over 31% annual growth during the second half of the 1990s. Unfortunately, real business investment retreated in 2001 and 2002. Real investment regained its legs in 2003, but its tentative steps resulted in a small 3.0% increase. Investment should be more sure footed this year, but the odds are against it returning to the full gallop it displayed in the late 1990s. The quicker pace of real business investment reflects the anticipated replacement demand for computers and peripheral devices. Computer systems and software purchased during the last expansion are quickly becoming technologically obsolete. As a result, many of these items are expected to be upgraded and/or replaced in the near future. Demand for computers and peripherals should also be augmented by the high productivity returns for investing in technology. Companies wanting to make these investments have found it relatively easy thanks to low interest rates, attractive depreciation treatment, and improved corporate cash flow. Idaho's computer and electronics sector showed signs of improvement in the first quarter of this year when employment posted its first gain in three years. Despite the first quarter's increase, Idaho computer and electronics employment growth should be flat in 2004. However, it is expected to expand 1.9% in 2005, 3.1% in 2006, and 3.9% in 2007. Unfortunately, one of the state's long-standing high-tech players will not contribute to this growth. Zilog closed its Nampa fabrication plant on June 23, 2004. About 150 jobs were lost due to this closure.

**Logging and Wood Products:** Idaho's logging and wood products employment should experience a brief reprieve from its recent string of losses. Like other Gem State resource-based sectors, lumber and wood products has suffered through challenging times. This sector's employment last peaked in 2000 at about 11,600 jobs. It has fallen in each of the three subsequent years. The worst year was 2001, when employment declined a whopping 14.9%. Employment fell by another 3.0% in 2002 and 5.3% in 2003. The closing of several mills over this period caused a portion of these declines. Approximately 125 jobs were lost when Boise Cascade shuttered its Cascade, Idaho mill in 2001. About 250 jobs were lost in 2002 when the company's Emmett, Idaho mill closed. Potlatch ceased operations at its Jaype Mill

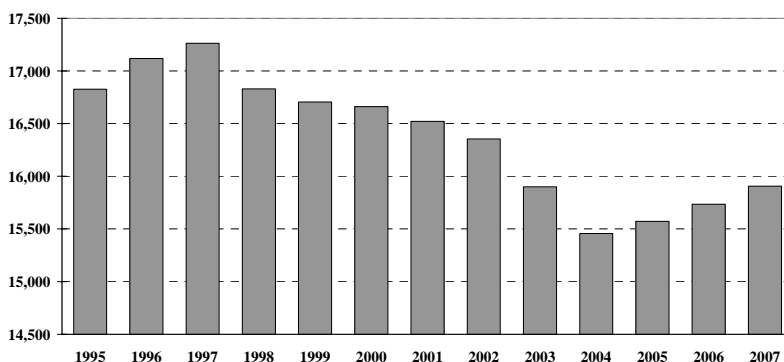
near Pierce, a move that cost about 215 jobs. Louisiana-Pacific closed its Bonners Ferry mill, putting about 140 people out of work. One of the reasons these mill closures are distressing is because their job losses are permanent. Unlike cyclical layoffs, where employees are recalled when business conditions improve, workers from closed mills have no place to return to work. It should also be pointed out that these jobs tend to be high-paying jobs and

the mill is often a community's major employer. As a result, the fallout from a mill closure is felt not just inside the mill's gate, but also throughout the community. What has been particularly frustrating is Idaho's lumber and wood products sector has been suffering during robust conditions that would have made it thrive in the past. This sector has traditionally prospered when the U.S. housing industry is healthy. The housing industry has indeed done well recently. The number of U.S. housing starts has increased in every year since 2000, and nearly 1.9 million starts are expected in 2004—its strongest showing since 1978. Under such strong demand Idaho lumber and wood products employment should rise. It has not. In fact it has decreased. This is because it is weighed down by supply factors. First, strong markets in the 1990s led to heavy capital investment in this sector. As a result, it is estimated the industry can produce 20% to 25% more lumber than is being consumed in North America and Canada. Second, the industry's problems have been compounded by the dearth of timber available from federal lands. A look at the last decade's harvests shows how steep the decline has been. According to the U.S. Department of Agriculture, 739 million board feet (mbf) were harvested in Idaho in 1991, or about 41% of the state total. In comparison, federal lands in Idaho yielded just 102 mbf a decade later, which was less than 10% of the total harvest. Third, unresolved fair trade issues between the U.S. and Canada are another source of uncertainty regarding future supplies. Idaho logging and wood products employment is expected to decline 4.7% in 2005, 3.7% in 2006, and increase 1.1% in 2007.

Idaho Logging & Wood Products Employment and U.S. Housing Starts



Idaho Food Processing Employment



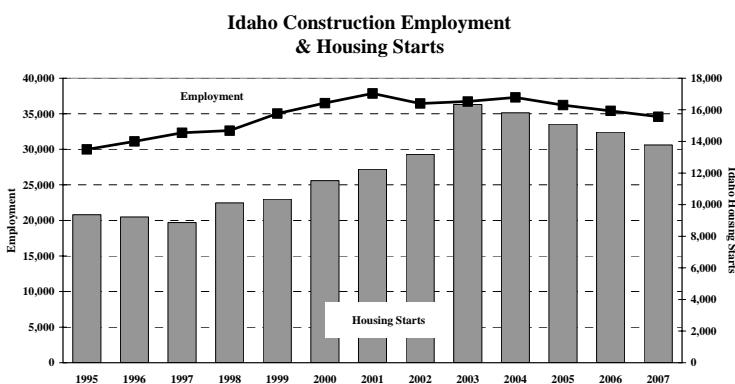
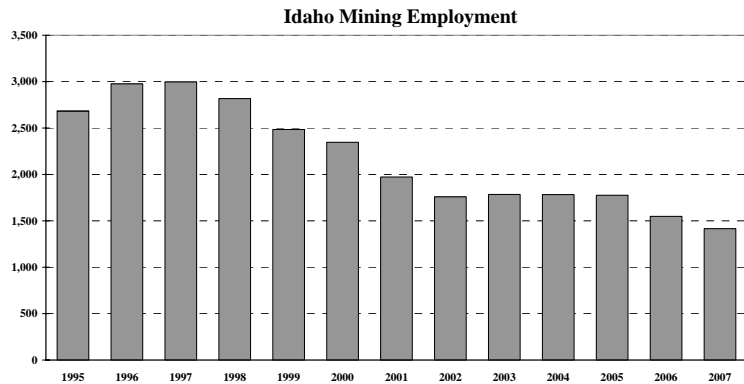
year-over-year declines coincide with the closure of major food processing facilities. For example, Simplot recently shuttered its Heyburn potato processing plant. The plant was built in 1960 and had run continuously since that time. Nearly 360 jobs were lost when unfavorable business conditions caused Simplot to also close its Nampa meat packing plant in the fall of 2003. Unfortunately, because the facilities will not be reopened, these jobs have been permanently lost. No new major potato processing plants are expected to be built in Idaho over the forecast period. This is because recent production

**Food Processing:** The Gem State's food processing sector will start to experience some long-awaited employment gains beginning in 2005, but these increases will not be robust enough to offset the losses it has experienced in recent years. The last time this sector's employment increased was in 1997. That year also represented the acme of employment. Since then employment has declined in every year. Some of the largest

additions have been built elsewhere. Canada has become a major player in the processed potato market. J.R. Simplot Company recently opened its newest plant in Canada.

**Mining and Chemicals:** It is difficult to see any relief on the horizon for Idaho's mining and chemical sectors. The state's mining sector is reviewed first. Over time, this sector has experienced both expansions and contractions consistent with the business cycle. Idaho mining employment fell from the beginning of 1991 until it hit a trough in 1993. Employment hit its next peak in 1997. The mining sector

has been shedding jobs since then. A clear pattern is that each successive mining employment peak is lower than the previous one. In other words, the expansions have not been able to replace the jobs lost when this sector contracted. This suggests there are structural factors reducing the employment prospects for this sector. This trend is expected to continue, and this does not bode well for the state's mining sector. Idaho chemical employment has also suffered setbacks. The most severe was the closure of the Astaris (formerly FMC) elemental phosphorous plant located just outside of Pocatello in 2002. For years this sector's employment was the epitome of stability, hovering near 2,300 since 1995. After the plant closure, employment plunged well below 2,000. While the number of jobs lost was small compared to overall employment, these were very high-paying jobs, and their absence is sorely missed. Readers may notice this decline pales in comparison to the 1,745 job loss from 1994 to 1995. This change reflects a reclassification of jobs at the Idaho National Engineering and Environmental Laboratory site. These jobs were not lost, but instead have been reassigned to the service sector.



**Construction:** The construction sector performed better than expected in the last quarter of 2003 and in the first quarter of 2004. This continues a pattern of pleasantly surprising construction growth. For example, in the January 2004 forecast it was predicted Idaho housing starts would begin declining at the end of 2003. Idaho construction employment was also expected to fall. However, current data suggest Idaho housing starts actually grew to about 18,100 units in 2003's fourth quarter. Not surprisingly, Idaho construction

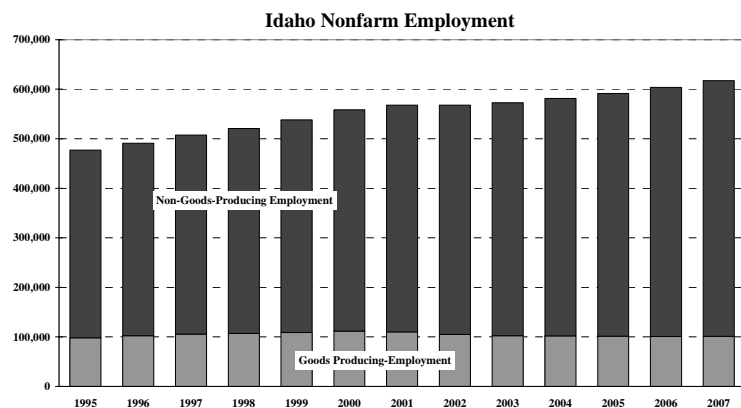
employment followed a similar path. Instead of falling as had been previously forecast, it actually expanded in the last quarter of 2003. These increases were considered when the April 2004 *Idaho Economic Forecast* was prepared. It was assumed at that time the increases in housing starts and construction employment were temporary phenomena exaggerated by seasonal factors, and both would begin retreating in the first quarter of this year. Experience has proved this assumption partially flawed. While housing starts did drop in the first quarter of 2004, construction employment actually rose. Specifically, in April 2004 it was forecast there would be around 15,000 annualized housing starts in the first quarter of 2004. Current data suggest there were approximately 16,500 starts. This helps to

explain why construction jobs increased in the same quarter, instead of decreasing per the previous forecast. The recent activity of housing starts and employment has been considered in the preparation of the current forecast. The housing data suggest Idaho housing starts have peaked, and they are expected to decline over the forecast period. However, the decline is not expected to be as severe as had been previously projected. The current forecast for Idaho housing starts in 2007 is 13,777, which is about 700 higher than in the previous forecast. Although Idaho construction employment showed surprising strength in early 2004, it will eventually be weighed down by the falling housing starts. Thus, after expanding to 37,302 in 2004, construction employment is forecast to drift down to 34,589 in 2007. These declines in Idaho housing starts and construction employment should be put in perspective. They represent a retreat from high levels of activity, and they are healthy by historical standards. For example, Idaho housing starts are expected to be 13,777 units in 2007—this is much higher than the three-decade average of about 8,800 units. Likewise, Idaho construction employment should remain comfortably above its historical average.

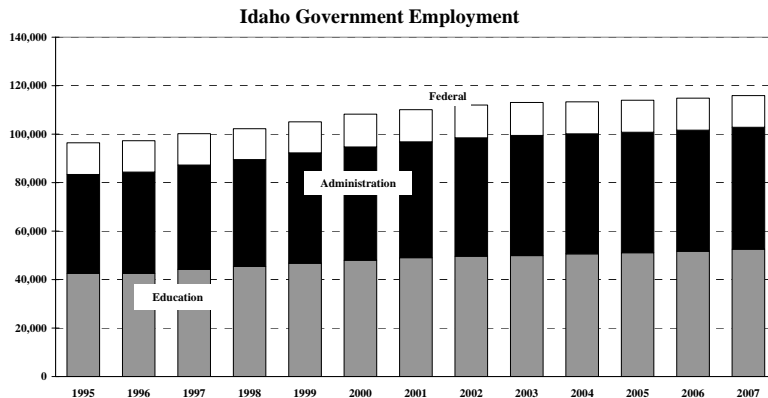
### **Nongoods-Producing Industries:** Most

of the state's nonfarm jobs are categorized as nongoods-producing jobs. In 2003, this sector accounted for over 80% of all nonfarm jobs in Idaho. Much of this is due to the sheer number of large job categories that come under the nongoods-producing moniker. For example, two of the largest nongoods sectors are services and trade. Together they account for three-fourths of nongoods-producing employment, or over 60% of Idaho total nonfarm employment.

The services category is the larger of the two categories and accounts for the lion's share of employment. The services sector can be split into its various components. The three largest services components are: professional and business services; education and health services; and leisure and hospitality services. The next group consists of service sectors with employment of around 20,000. Financial services; transportation, warehousing, and utilities; and other services make up this group. The smallest sector is information services. The trade category can be divided into retail and wholesale pieces, with retail being the larger of the two sectors. Given the diversity of the components making up the nongoods-producing sector, it is easier to forecast its employment from the bottom up versus the top down. That is, a forecast should be made for each component and then these components should be summed to get an aggregate forecast for nongoods-producing employment. That being the case, a short summary for each component is provided. The outlook for professional and business services employment should be one of this sector's strongest performers. After experiencing relatively anemic showing in 2003, its job growth should accelerate over the forecast period, so that by 2007 it is adding jobs at over three times its 2003 pace. Education and health services employment should benefit from the state's continued, albeit slower, population growth and the increased demand for health services caused by the aging population. Education and health services should grow 3.3% annually. The outlook for leisure and hospitality employment will be determined by several factors. On the plus side, domestic tourism is expected to benefit from the weak dollar, high airline fares for international travel, and fears about traveling abroad. On the minus side, Idaho travel could be hampered this summer by high gasoline prices and a limited water recreation season caused by the low mountain snowpack. The current forecast calls for leisure and hospitality services employment to increase an average of 3.2% annually. Since retail is closely tied with tourism, it will be interesting to see how well it weathers the



factors affecting the hospitality and recreations category. For example, it remains to be seen whether the weaker dollar will lure Canadian shoppers back into northern Idaho shops or whether high gasoline prices will keep them home. Idaho's high-quality labor force should continue to attract call centers, which help the number of information services jobs grow 3.7% annually. Other services should advance 2.1% yearly. Financial services employment growth is projected to average 2.2%, while transportation, warehousing, and utilities are expected to average 1.4% growth. The trade sector can also be broken out this way. Retail trade should average 2.4% growth over the forecast period, while wholesale trade advances at a 0.8% yearly pace. Overall, total employment in Idaho's nongoods-producing sector is forecast to rise 2.0% in 2004, 2.2% in 2005, 2.6% in 2006, and 2.6% in 2007.



**Government:** Idaho state and local government employment is forecast to grow much slower over the forecast period than its historical 2.7% annual average. In fact, this measure is expected to muster just 0.7% growth in both 2004 and 2005, rise 0.9% in 2006, and increase 1.1% in 2007. The main reason for this slower-than-average growth is the cooling of population growth. A little history adds a bit of perspective. From 1990

to 2000 the Gem State experienced a boom during which its population grew over 27%, or an average of about 2.5% per year. In comparison, the U.S. economy grew about half as fast as Idaho during that decade. Idaho's fast-growing population increased the demand for government services, and overall state and local government employment growth averaged 3.0% from 1991 to 2000. Idaho's population growth is expected to shift into lower gear over the forecast period and advance about 1.5% annually. Another factor dampening government employment growth is state-mandated budget caps for local governments. As a result of these factors, Idaho state and local government employment grow less than 1.0% per year over the forecast horizon. While the focus so far has been on aggregate employment, the projection can be broken out by its education and non-education components. Idaho education employment should actually fare better than total state and local government employment over the forecast period. Specifically, it is anticipated to expand 1.4% this year, 1.0% next year, 1.2% in 2006, and 1.6% in 2007. The above average growth of this component of Idaho state and local government employment implies non-education employment will experience sub-par growth. Indeed, Idaho non-education employment is forecast to decrease slightly in 2004 and increase well under 1.0% in the remaining years of the forecast. The federal government component is a relatively small part of Idaho employment. It accounted for 13,621 jobs, or about 2.4% of total nonfarm employment. In contrast, there were nearly 100,000 state and local jobs in Idaho. The fate of the federal government sector owes more to budget writers on the Potomac than to local policy makers. Given current federal budget deficits it is likely Uncle Sam will be less generous to the states in the future, and this will dampen federal employment prospects in Idaho. Another risk to employment is the possibility of more rounds of military base closures in the near future. Federal government employment in Idaho is expected to shrink slowly over the next few years, going from 13,621 in 2003 to 13,117 in 2007.